Reconciling Inventory to the General Ledger

INVENTORY DETAIL VERSUS INVENTORY SUMMARY

The following document briefly outlines some key areas many users overlook when attempting to balance Inventory Value (On-hand * Average Cost) with the General Ledger Inventory (updated through Receiving and the A/P system). This list is not meant to be all inclusive, but details the most common causes of discrepancies.

Menu 13.20.2 is the only supported process by which stores, whose desire is to balance Inventory Value to General Inventory, can ensure that what is being entered into the inventory system via PO receipts posting matches that which is entered into the A/P system and subsequently the General Ledger. Care must be taken to match all PO receipts to vendor invoices, with reconciliation and cost discrepancies entered through the Purchase Order Receipts Update to A/P process (13.20.2).

EVERY transaction in the system is based on average cost; therefore an incorrect average cost can cause errors with extreme repercussions, such as over/understatement of profits, over/under payment of taxes, miscalculation of inventory turns, or over/undervaluation of inventory.

POTENTIAL PROBLEMS:

1) Product has been received but not yet vouchered into the Accounts Payable system - Inventory value is updated at receiving time (i.e. as soon as the on-hand increases due to a PO receipt). However, the G/L Inventory is not updated until the vendor invoice has been vouchered and the Inventory G/L account debited for the amount of the merchandise received.

2) Inventory adjustments have not been properly entered into the General Ledger via a Journal Entry - The Daily Inventory Transaction Audit Report that runs with each Day End lists all inventory adjustments that have been made for the day. These adjustments directly affect the product on-hand quantity and consequently the inventory value. A journal entry must be made to the Inventory G/L account for all inventory adjustments made throughout the month to properly reflect these changes in the General Ledger inventory value. Depending on your corporate structure, it is possible to have this entry automated.

3) The difference between the PO receipt cost/quantities and the vendor-invoiced cost/quantities does not agree - It is necessary to properly record any differences between the product cost at PO receiving time and the actual cost invoiced from the vendor.

4) Incorrect use of the Warranty System…vendor credits do not match credits issued through the warranty claim - When closing warranty claims, vouchers should be expensed only to the Warranty A/R account. Also, when issuing vendor credits, the actual credit amount from the vendor should be used. Separate Accounts should be used for Warranty AR and Warranty Clearing. Inventory Account should NOT be used for warranty transactions.

5) Incorrect or non-posting of the Inventory Buyback - The Inventory Buyback process reduces on-hand (and subsequently inventory value). It is therefore necessary to make a journal entry to reflect this change in the G/L inventory value.

6) Incorrect or non-posting of the Physical Inventory variance - The Physical Inventory process updates on-hand (and subsequently inventory value) at the time the inventory is updated. It is therefore necessary to make a journal entry to reflect this change in the G/L inventory value.

7) PO Receipts posting of items not carried as inventory – Such items should have their Bypass flag set to 'Y'es to avoid updating their on-hand (and subsequently inventory) values. Also, these items should not be received, as their on-hand value should always remain at zero AND average cost should always be at $0.

8) Failure to utilize 13.20.2 Purchase Order Receipts Update to A/P to record vendor invoices and cost changes - 13.20.2 is the only supported process by which stores, whose desire is to balance Inventory Value to General Inventory, can ensure that what is being entered into the inventory system via PO receipts posting matches that which is entered into the A/P system and subsequently the General Ledger. Care must be taken to match all PO receipts to vendor invoices, with reconciliation and cost discrepancies entered through the Purchase Order Receipts Update to A/P process (13.20.2).

9) Reopening POs – this has negative repercussions on average cost – especially when there are multiple receivers for a purchase order. Average Cost is recalculated EVERY time a PO is received and reopening and rereceiving a PO causes multiple updates to average cost, in error.

10) Manually updating inventory average cost incorrectly – this is a "privilege "that only a select few should have access to and only if they are well versed on the math calculation that determines average cost. Average Cost is password protected for a reason and great care should be taken when updating average cost to ensure that the calculation is done correctly and that the reason for recalculating average cost is legitimate.

11) Omitting or incorrectly preparing journal entry for store transfers – if this is a manual entry an extra care should be taken to make sure the debits/credit are handled correctly and from/to the right stores. Depending on your corporate structure, it is possible to have this entry automated.

12) Making journal entries or AP postings to inventory that you shouldn't – rebates, freight, credits, etc. These are transactions that should be run through income/expense accounts, NOT balance sheet accounts.

13) Not accounting for Drop ships correctly – both the purchase order and the customer invoice have to be set up as dropships (DIN and DPO) so that the quantity on hand is not impacted.

14) Invoicing before Receiving – it is crucial to maintain the integrity of the average cost calculation, and in order to do so, parts NOT be invoiced before they are received. Receiving should ALWAYS occur before invoicing, not just within the same day.

15.) Changing the cost on the line item detail in OE is a practice that should not be encouraged. By changing the cost in the invoice, you are relieving inventory and updating cost of goods with the entered costs and not with the average cost. Balancing inventory will be impossible and the cost of goods amount on the income statement will be incorrect.